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Supreme Court of the United States

OCTOBER TERM, 1948

No. 442

HANNAH COHEN, Executrix of the Estate of SOL COHEN, deceased, and DAVID E. COHEN, Intervenor,
Petitioners,

vs.

BENEFICIAL INDUSTRIAL LOAN CORPORATION, *et al.*,
Respondents.

No. 512

BENEFICIAL INDUSTRIAL LOAN CORPORATION,
Petitioner,

vs.

HONORABLE WILLIAM F. SMITH, a Judge of the United States District Court for the District of New Jersey, *et al.*,
Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION FOR LEAVE TO FILE BRIEF
AND
BRIEF FOR WILLIAM B. WEINBERGER AS *AMICUS CURIAE*

JULIUS LEVY,
Attorney for William B. Weinberger, amicus curiae,
295 Madison Avenue,
New York 17, N. Y.

WILLIAM E. HAUDEK,
on the Brief.

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Supreme Court of the United States

OCTOBER TERM, 1948

No. 442

HANNAH COHEN, Executrix of the Estate of SOL COHEN, deceased, and DAVID E. COHEN, Intervenor,
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vs.

BENEFICIAL INDUSTRIAL LOAN CORPORATION, *et al.*,
Respondents.

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vs.

HONORABLE WILLIAM F. SMITH, a Judge of the United States District Court for the District of New Jersey, *et al.*,
Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

PETITION OF WILLIAM B. WEINBERGER FOR LEAVE TO FILE A BRIEF *AMICUS CURIAE*

TO THE HONORABLE CHIEF JUSTICE AND THE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

The petitions of William B. Weinberger respectfully shows to this Court and alleges:

1. Petitioner respectfully asks the Court's permission to file the annexed brief *amicus curiae* on the constitutional

validity of § 14:3-15 of the Revised Statutes (Cum. Supp.) of the State of New Jersey. The constitutional validity of the statute is directly before this Court on the writs of certiorari granted in the two above-entitled cases.

2. R. S. 14:3-15 provides, in substance, that the plaintiff in a stockholder's derivative action, who owns less than 5% or $50,000 worth of his corporation's stock, shall be required to give security for the reasonable expenses, including attorneys' fees, which may be incurred by the corporation and the other defendants in the action. The full text of said statute appears in the brief submitted herewith.

3. Petitioner is the plaintiff in a stockholder's derivative action pending in the Supreme Court of the State of New York, County of New York, entitled "William B. Weinberger v. Milton Sperling, et al." (County Clerk's Index No. 3768/1949). By decision of said Court (New York Law Journal, March 15, 1949, p. 943, col. 1), petitioner has been required, pursuant to § 61-b of the General Corporation Law of New York, to give security in the sum of $25,000 for the defendants' expenses; and the prosecution of said action has been stayed until such time as the security may be given.

4. Petitioner intends to appeal from said decision on the ground that § 61-b of the General Corporation Law of New York is contrary to the due process and equal protection clauses of the Fourteenth Amendment to the Constitution.

5. R. S. 14:3-15 of New Jersey is substantially identical with § 61-b of the General Corporation Law of New York. The full text of § 61-b appears in the brief submitted herewith. The decision of this Court regarding the constitutionality of R. S. 14:3-15 will therefore control the disposition of petitioner's appeal in his New York State Court action.

6. For the foregoing reasons, petitioner has a direct and immediate interest in the decision of the constitutional questions presented to this Court.

7. It is respectfully submitted that petitioner's *amicus curiae* brief, presented herewith, sets forth certain factual and statistical data having important bearing upon said constitutional questions. Such data, it is believed, has so far not otherwise been submitted to this Court.

8. The attorney for Hannah Cohen and David E. Cohen (petitioners in No. 442, respondents in No. 512), by letter submitted herewith, consents to the filing of the *amicus curiae* brief. John M. Harlan, Esq., the attorney for Beneficial Industrial Loan Corporation (respondent in No. 442, petitioner in No. 512), has been requested to consent, but has refused.

9. No previous application for the relief herein sought has been made.

10. The reason this petition is not verified by petitioner personally is that petitioner is not within the State of New York but in Florida, and his signature could not be obtained in sufficient time for the filing of this petition. Your deponent is a member of the Bar of the Supreme Court of the United States; he is one of the attorneys for petitioner in his above mentioned New York State Court action; and he is authorized to file this petition on behalf of petitioner.

WHEREFORE, it is respectfully requested that leave to file the *amicus curiae* brief submitted herewith be granted.

Dated, March 31, 1949.

JULIUS LEVY,
Attorney for Petitioner,
William B. Weinberger,
Office & P. O. Address,
295 Madison Avenue,
New York 17, N. Y.

State of New York }
County of New York } ss.:

Julius Levy, being duly sworn, says that he is the attorney for the petitioner in the above entitled action; that the foregoing petition is true of his own knowledge, except as to the matters therein stated to be alleged on information and belief, and that as to those matters he believes it to be true.

Deponent further says that the reason why this verification is not made by said petitioner is that he is not within the County of New York, which is the county where the deponent has his office.

Julius Levy.

Sworn to before me this
31st day of March, 1949.

Ethel Radix
Notary Public in the State of New York
Residing in Kings County
Kings Co. Clk. No. 23, Reg. No. 108-R-0
N. Y. Co. Clk. No. 268, Reg. No. 212-R-0
Commission expires March 30, 1950

Supreme Court of the United States

OCTOBER TERM, 1948

No. 142

HANNAH COHEN, Executrix of the Estate of SOL COHEN, deceased, and DAVID E. COHEN, Intervenor,

Petitioners,

vs.

BENEFICIAL INDUSTRIAL LOAN CORPORATION, *et al.*,

Respondents.

No. 312

BENEFICIAL INDUSTRIAL LOAN CORPORATION,

Petitioner,

vs.

HONORABLE WILLIAM F. SMITH, a Judge of the United States District Court for the District of New Jersey, *et al.*,

Respondents.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR WILLIAM B. WEINBERGER AS *AMICUS CURIAE*

This brief is confined to the question whether § 14:3-15 of the Revised Statutes (Cum. Supp.) of New Jersey,*

* N. J. R. S. Cum. Supp. 14:3-15, N. J. S. A. 14:3-15, provides: "In any action instituted or maintained in the right of any domestic or foreign corporation by the holder or holders of shares, or of voting trust certificates representing shares, of such corporation having

generally and as applied to this case, is unconstitutional. We submit that the statute violates the due process and equal protection clauses of the Fourteenth Amendment to the Constitution.*

The jurisdictional and other formal recitals, as well as a statement of the facts, appear in petitioners' brief. To avoid repetition, the Court is respectfully referred thereto.

In short, R. S. 14:3-15 requires the plaintiff in a stockholder's derivative action, who owns less than 5% or $50,000 worth of his corporation's stock, to give security for the reasonable expenses, including attorneys' fees, which may be incurred by the corporation and the other defendants in the action. The security may from time to time be increased or reduced if it becomes inadequate or excessive.

Respondent here has demanded security in the sum of $125,000 (R. 9). While the Court below thought that "this estimate may well be taken with salt", it entertained "no doubt that the amount involved will be large" (R. 31).

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a total par value or stated capital value of less than five per centum (5%) of the aggregate par value or stated capital value of all the outstanding shares of such corporation's stock of every class, exclusive of shares held in the corporation's treasury, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars ($50,000.00), the corporation in whose right such action is brought shall be entitled, at any stage of the proceeding before final judgment, to require the complainant or complainants to give security for the reasonable expenses, including counsel fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to law, its certificate of incorporation, its by-laws or under equitable principles, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter, from time to time, be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive."

Amendment XIV, § 1: " * * nor shall any State deprive any person of life, liberty or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws."

Previous Authorities

R. S. 14:3-15 was modeled after § 61-b of the General Corporation Law of New York * (R. 51). While the constitutionality of the New York statute was sustained in *Lapchak* v. *Baker*, 298 N. Y. 89 (1948), the appellate review there was limited to the abstract question whether a stockholder-plaintiff may constitutionally be required to give security "in any amount whatever", however small or reasonable. Since here the Court below already held that the security will be "large", the *Lapchak* ruling is not pertinent.

In the lower New York courts § 61b was sustained in:

Shielcraut v. *Moffett*, 49 N. Y. S. 2d 64, aff'd 268 App. Div. 352 (two judges dissenting), rev'd on other grounds 294 N. Y. 180 (1945);

Baker v. *McFadden Publications, Inc.*, 270 App. Div. 440 (1st Dept., 1946, two judges dissenting), app. den. 270 App. Div. 840.

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* "§ 61-b. Security for expenses: In any action instituted or maintained in the right of any foreign or domestic corporation by the holder or holders of less than five per centum of the outstanding shares of any class of such corporation's stock or voting trust certificates, unless the shares or voting trust certificates held by such holder or holders have a market value in excess of fifty thousand dollars, the corporation in whose right such action is brought shall be entitled at any stage of the proceedings before final judgment to require the plaintiff or plaintiffs to give security for the reasonable expenses, including attorney's fees, which may be incurred by it in connection with such action and by the other parties defendant in connection therewith for which it may become subject pursuant to section sixty-four of this chapter, to which the corporation shall have recourse in such amount as the court having jurisdiction shall determine upon the termination of such action. The amount of such security may thereafter from time to time be increased or decreased in the discretion of the court having jurisdiction of such action upon showing that the security provided has or may become inadequate or is excessive" (22 McKinney's Consol. Laws of New York Annot., 1948 Supp., p. 76).

But the section was held invalid for violation of the due process and equal protection clauses of the Constitution in

Citron v. *Mangel Stores Corp.*, 50 N. Y. S. 2d 416 (1944).

The constitutionality and economic implications of § 61-b have been the subject of extensive discussion in the legal literature:

Zlinkoff, The American Investor and the Constitutionality of § 61-b of the New York General Corporation Law (1945), 54 Yale L. J. 352;

Hornstein, The Death Knell of Stockholders' Derivative Suits in New York (1944), 32 Calif. L. R. 123;

Hornstein, New Aspects of Stockholders' Derivative Suits (1947), 47 Columbia L. R. 1;

House, Stockholders' Suits and the Coudert-Mitchell Laws (1945), 20 N. Y. Univ. Law Quart. Rev. 377;

Jackson, Reorganization of the Corporate Concept (1944), 5 Corp. Reorg. and Amer. Bankruptcy Rev. 323;

Purcell, Foster and Hill (Practising Law Institute), Corporations: Enforcing the Accountability of Corporate Management and Related Activities of the S. E. C. (1946), pp. 11-17;

Carson, Further Phases of Derivative Actions (1944), 29 Cornell L. Q. 431;

Note (1944), 58 Harvard L. R. 135.

POINT I.

Due Process of Law.

No intelligent appraisal of the validity of a statute attacked on constitutional grounds is possible without analysis of the legal and factual setting in which it operates, the relevant social and economic conditions, the purposes

it is designed to accomplish and the practical results of its application. *Borden's Farm Products Co.* v. *Baldwin*, 293 U. S. 194, at 211, 213 (1934). Accordingly we shall discuss the useful and indeed indispensable functions heretofore performed by stockholders' derivative actions; their virtual destruction through the new statute without substitution of any other mode of relief; the immunity thereby secured to faithless corporate managements; and the complete absence of any reasonable relation between this radical destruction of stockholders' and corporations' rights and the evils which the statute was purportedly designed to cure.

A

Functions of the stockholder's derivative suit

Stockholders' derivative actions have been entertained in our Courts and those of England for more than a century. *Hichens* v. *Congreve*, 4 Russ. 562, 38 Eng. Rep. 917 (Ch. 1828); *Dodge* v. *Woolsey*, 18 How. (59 U. S.) 331, at 341-2 (1856); *Robinson* v. *Smith*, 3 Paige (N. Y.) 222 (1832). The eminent usefulness, nay, the absolute necessity of the stockholder's suit has been recognized even by those critical of its incidental abuses.*

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* *Havens* v. *Oakland*, 104 U. S. 450, at 453 (1882):

"The exercise of this power [of equity] in protecting the stockholder against the frauds of the governing body of directors or trustees, and in preventing their exercise, in the name of the corporation, of powers which are outside of their charters or articles of association, has been frequent, and is most beneficial, and is indisputed."

Isensee v. *Long Island Motion Picture Co.*, 184 Misc. 625, at 628 (1945):

"Stockholders' suits provide a wholesome remedy and often the only direct means of exposing mismanagement and corruption in the direction of corporate activities."

Shielcraft v. *Moffett*, *supra*, 49 N. Y. S. 2d. at 72 (quoting the "non-partisan Citizens Union"):

"In spite of abuses, minority stockholders' suits have been an effective means of holding large corporations in restraint and

The huge amounts of corporate moneys recovered from derelict fiduciaries in actions of this type bear witness to the essential function which the stockholder's suit performs in protecting the investing public. Nor are the actual dollars restored to corporate treasuries a full measure of the social benefits of stockholders' suits. In *Brendle* v. *Smith*, 46 F. Supp. 522, at 525-6 (D. C., S. D. N. Y., 1942), Judge Rifkind held:

> "Despite the numerous abuses which have developed in connection with such suits, they have accomplished much in policing the corporate system, especially in protecting corporate ownership as against corporate management. They have educated corporate directors in the principles of fiduciary responsibility and undivided loyalty. * * * *The measure of effectiveness of the stockholder's derivative suit cannot be taken by a computation of the money recovery in the litigated cases. The minatory effect of such actions has undoubtedly prevented diversion of large amounts from stockholders to managements and outsiders.*" (Italics added.)

But the stockholder's suit is not only a valuable, it is, in fact, "the *only* civil remedy that stockholders have for breach of fiduciary duty on the part of those entrusted with the management and direction of their corporations"; *Bayer* v. *Beran*, 49 N. Y. S. 2d 2, at 4 (1944, Shientag, J., italics added); *Shielcraft* v. *Moffett*, *supra*, 49 N. Y. S. 2d, at 71 (quoting Rosenman, J.). But for the stockholder's action, stockholders would be totally without redress for managerial wrongdoings. No court, no administrative agency would be open for their complaints.

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preventing them from wasting large sums of the stockholders' money for the benefit of a favorite few."

Carson, Current Phases of Derivative Actions Against Directors (1942), 40 Mich. L. R. 1125, at 1127:

> "It is clear that the stockholders' derivative suit is an absolutely necessary arm of equity jurisdiction and that, when used with justice and restraint, it has both public and private value."

More than that. The stockholder's suit, if it can be brought at all, is the only avenue of redress for the *corporation* itself. For a stockholder's suit lies only when the directors, in failing to seek redress, "are guilty of misconduct equivalent to a breach of trust; or where they stand in a dual relation which prevents an unprejudiced exercise of judgment": *United Copper Securities Co.* v. *Amalgamated Copper Co.*, 244 U. S. 261, at 264 (1917, Brandeis, J.); *Koral* v. *Savory, Inc.*, 276 N. Y. 215, at 218 (1937). The corporation thus has, by hypothesis, a valid cause of action against its faithless fiduciaries; it has the right to seek judicial relief; but the right is no more than theoretical since those in control of the corporation will not and cannot enforce it; and it must ultimately be barred by the statute of limitations. Unless a stockholder can intercede by derivative action, the corporation's right is nullified as certainly as though all right to relief were denied to the corporation in so many words.

B

The destruction of these rights by R. S. 14:3-15

1. *The amount of security:*

The statute does not limit the amounts of the attorneys' fees to be secured, except that they must be "reasonable". Security, even though "reasonable", may be prohibitive. The difficulties and complexities involved in many stockholders' actions are familiar. It is neither unusual nor unreasonable for the defendants in such actions to retain distinguished counsel. Stockholders' actions are ordinarily directed against several defendants, each of whom is entitled to counsel of his own choice. The anticipated aggregate "reasonable" charges of several prominent law firms for services in a protracted and intricate litigation are bound to be formidable (*Citron* v. *Mangel Stores Corp.*, *supra*, 50 N. Y. S. 2d, at 419). The amounts of security which have heretofore been required under § 61-b have

ranged from $5,000 to $75,000*; and experience indicates that defendants' expenses have repeatedly exceeded $100,000. *New York State Chamber of Commerce, Survey and Report Regarding Stockholders' Derivative Suits* (1944), p. 8 (hereinafter referred to as "*Chamber Report*").

Nor is this all. Under the statute the court is expressly empowered, at any stage of the proceedings before final judgment, to require further security. A stockholder able and willing to give security faces therefore the indefinite risk of putting up additional amounts, failing which he will be dismissed and forfeit his original bond.

2. *Prohibitive character of the security:*

This great burden is imposed by the statute not on every stockholder, but only on the small one. If the shares of the stockholder-plaintiff have a market value of no more than $50,000 and represent less than five percent of the corporation's outstanding capital stock, he must give security; and upon ultimate dismissal the security is applied to the payment of defendants' litigation expenses. But if his stock amounts to at least five percent or more than $50,000 worth, he may not be called upon to give security; and even if his suit is ultimately dismissed, he is under no liability for the defendants' attorneys' fees, *Isensee* v. *Long Island Motion Picture Co., supra*, 184 Misc., at 629.**

The paradoxical operation of R.S. 14:3-15 thus is to put a heavy financial burden on those stockholders who are least able to bear it, namely, the small ones; and to exempt those who could best afford it, namely, the large ones.

In the practical operation of the statute, the small stockholder will, of course, not furnish the security which he is

* Thus security of $75,000 was required, at the very eve of trial, in *Tichner* v. *Andreas*, (N. Y. County Clerk's Index No. 13696—1945), resulting in dismissal of the action.

** The Court below has held (R. 59) that this New York decision will presumably be followed in New Jersey.

called upon to give. In most instances he will lack the means. Even if he has them, his individual stake in the litigation will be insufficient to warrant the huge risk which R.S. 14:3-15 would impose on him. The average stockholder in the modern giant corporation holds but an infinitesimal fraction of the outstanding capital stock; and even the largest single stockholder therein may fall short of the five percent requirement of the statute.* The pro-

* Dispersion of stock ownership is well described in *Berle and Means, The Modern Corporation and Private Property* (1932), pp. 47-48:

> "As is to be expected, the process of stock dispersion has proceeded furthest in the very large companies. The stockholder lists of the largest railroad, Pennsylvania Railroad, the largest public utility, the American Telephone and Telegraph Company, and the largest industrial, the United States Steel Corporation, show in each case that the principal holder in 1929 owned less than one per cent of the outstanding stock. The most important holdings reported were, respectively, .34 of one per cent, .70 of one per cent, and .90 of one per cent. In these companies no single individual holds an important proportion of the total ownership. Even the aggregate holdings of the twenty largest stockholders of the Pennsylvania Railroad amounted in 1929 to only 2.7 per cent, of the Telephone Company to 4.0 per cent, and of the Steel Company to 5.1 per cent. Below the first twenty, the amount held by each stockholder dropped off rapidly to insignificant proportions. The twentieth holder of Railroad stock owned but .07 of one per cent, of Telephone stock .09 of one per cent, and of Steel stock but .09 of one per cent. The remainder of the half million Telephone stockholders, the 196,119 stockholders of the Railroad and the 182,585 holders of Steel stock were negligible as individual holders.
>
> "In the dispersion of stock these companies are in the lead but are not alone. In many large companies the largest stockholding represents a small proportion of the total ownership while the number of stockholders is legion."
>
> (There follows a list of fourteen corporations in which the size of the largest holding varies from 0.76% to 2.74%.)

For more recent statistics see: *Temporary National Economic Committee, Monograph 29* (1940), *The Distribution of Ownership in the 200 Largest Nonfinancial Corporations*, pp. 69 *et seq.*, 623 *et seq.* Of the 208 common stock issues analyzed, 74 were so distributed that no one stockholder held more than 5% (*ibid.*, p. 91).

portionate share of any individual stockholder in the proceeds of a successful derivative action is thus utterly out of proportion to his risk of loss, under the statute, if his suit should fail. For the average stockholders, whose proportionate beneficial interest in any corporate recovery is infinitesimal, it would be rank madness to furnish the statutory security.

Nor does the statutory exemption of stockholders owning $50,000 worth of shares afford appreciable relief. Recent studies disclose that individual stockholdings are not only infinitesimal in terms of percentages of the whole; they are also comparatively minute in terms of dollar values. It has been shown that the average block of any stock held by a single shareholder has a value of only $3,000; and of the fourteen million record stockholders in our key corporations, less than 2% own blocks worth $50,000 or more.* Such large stockholders as there are will often be identified with the management. The statutory exemption granted to $50,000 stockholders is thus without practical significance.

These conditions are illustrated by the dispersion of stockholdings in the respondent corporation, as shown in *Standard Corporation Descriptions*, published by *Standard & Poor's Corporation* (June, 1948, pp. 2397-9).** Respondent corporation had outstanding, as of December 31, 1947, 100,000 shares of preferred and 2,383,100 shares of common stock. The preferred stock may be ignored since it was issued in 1946, long after the transactions com-

* A recent analysis of the distribution of shareholdings discloses that the stocks of 1,710 key corporations are owned by about fourteen million record stockholders. 90% of all shareholdings analyzed had a value of less than $5,000; 96% had a value of less than $10,000; and 98% had a value of less than $50,000. *Temporary National Economic Committee, Monograph 30* (1941), *Survey of Shareholdings in 1710 Corporations with Securities listed on a National Securities Exchange*, p. 20; *Zlinkoff, supra*, 54 Yale L. J., at 367-8.

** Statistical information of this type is judicially noticed by this Court; see *Insurance Group Committee v. Denver & R. G. W. R. Co.*, 329 U. S. 607, at 617, fn. 6.

plained of (see Fed. Rule 23(b)). Of the common stock, respondent's parent, Beneficial Corporation, owned 882,000 shares, i.e., 37%. The remaining 1,500,000 common shares were held by about 17,000 stockholders, whose average holdings thus amounted to 88 common shares. In other words, the average common stockholder of respondent owns 0.003% of its outstanding common stock; and at an average market value of $25 per common share, the average block of common stock held by any one stockholder is worth $220.

It may thus readily be seen that R. S. 14:3-15 precludes the overwhelming majority of respondent's common stockholders from vindicating their own rights and those of their corporation.

3. *Impracticability of joining a sufficient number of stockholder-plaintiffs:*

To overcome the insuperable difficulty of furnishing the statutory security, Governor Dewey of New York made this suggestion:

> "Even if the stockholder owns a tiny percentage or $5,00 worth of stock, it should still be simple to bring an action without putting up security. If his action has any merit at all, it should be easy enough to interest others who do hold at least five percent or stock valued at $50,000". (Governor's Message accompanying his approval of § 61-b of the New York General Corporation Law; see 22 *McKinney's Consol. Laws of New York Annot.*, 1948 Supp., pp. 76-77).

Actually, however, this course is neither "simple" nor "easy"; on the contrary, it is quite as impracticable as giving the statutory security.

The wide dispersion of stock ownership in the large modern corporation has already been adverted to. The only practical means of enlisting the joinder of sufficient stockholders is by circularization. The names and addresses of stockholders can be garnered only from the

stock book of the corporation; the management will be none too eager to lay it open; and the courts have shown little inclination to assist the plaintiff in enforcing its inspection (see *Baker* v. *McFadden Publications, Inc.*, *supra*, 270 App. Div. 440).

Assuming this difficulty overcome, communication with the stockholders is exceedingly costly (*House*, *supra*, 20 N. Y. Univ. L. Quart. Rev., at 378). Taking into account that, to convince others of the merits of his claim, the soliciting stockholder must disclose his full charges, with all supporting evidence, and that he will have to reply to answers of the management, it is plain that the expense of enlisting the cooperation of other stockholders will equal, if not exceed, the cost of a bond required under R. S. 14:3-15.*

And what will be the effect of circularization? The extreme difficulty of inducing concerted action by stockholders of publicly-held companies, such as the respondent, is too familiar to require elaboration. See Professor (now Mr. Justice) *Douglas, Directors Who do not Direct* (1934), 47 Harvard L. R. 1305, at 1316. And this is not a case where stockholders are merely called upon to vote in favor of or against proposed corporate action. If the action is to be brought at all, the required number of stockholders must actually join therein. Many a stockholder, although persuaded of the merits of the case, will be reluctant to assume the expense, risk and annoyance of becoming a party plaintiff in a stockholder's action. In-

* It has been judicially recognized that the "dubiously effective medium of extensive newspaper advertisements aimed at rallying together scattered minority interests" is "almost prohibitively costly": *Delatour* v. *Meredith*, 144 F. 2d. 594, at 596 (C. C. A. 2, 1944). See also the testimony of Commissioner (now Mr. Justice) *Douglas*, *Hearings before House Judiciary Committee* on H. R. 6439 (amended and reported as H. R. 8406), 75th Cong., 1st Sess., 1937, 188. In one instance the cost to the minority interests of a closely fought proxy battle has been reported at $300,000: *Temporary National Economic Committee, Monograph No. 11, Bureaucracy and Trusteeship in Large Corporations* (1940), p. 20.

ability to join with others is thus obviously no gauge of the merits or demerits of the complaining stockholder's case.

But assume that a sufficient number of stockholders has been persuaded to take action. Will they really be able to meet the requirements of R. S. 14:3-15? The statute forestalls such possibility. For, simultaneously with the enactment of R. S. 14:3-15, the Legislature of New Jersey adopted a statute * which, like Rule 23 of the Federal Rules, requires the stockholder-plaintiff to show that he owned his shares at the time of the wrongs complained of. If any appreciable time elapses between the wrongs complained of and the institution of suit, the rapid turnover of stockholders in our publicly-held corporations will so narrow the number of stockholders qualified to sue as to make the requisite joinder impracticable.

Against this background of fact and law, we submit that the recommendation of joining with other stockholders sufficient to avoid the security requirement of R. S. 14:3-15 is hardly more than an empty gesture.

4. *Denial of the remedy is equivalent to destruction of the right:*

To recapitulate: In our large publicly-held corporations no one stockholder—unless identified with the management—owns five percent of the outstanding stock; the average stockholder owns only a small fraction of one percent. Ninety-eight percent of the stockholders own less than $50,000 worth of stock. For the small stockholder it is impossible or impracticable to furnish the

* Chapter 131, Laws of 1945, § 2 (New Jersey), provides: "In any action, suit or proceeding brought or maintained in the right of a domestic or foreign corporation by the holder or holders of shares or of voting trust certificates representing shares of such corporation, it must be made to appear that the complainant was a shareholder or the holder of a voting trust certificate at the time of the transaction of which he complains or that his share or voting trust certificate thereafter devolved upon him by operation of law."

security required by the statute or to join with the requisite number of other stockholders. The plain effect, if not the purpose of R. S. 14:3-15 thus is to bar the corporation and its stockholders from any redress for the misconduct of those in control.

Experience demonstrates the lethal effect of the statute. Since the enactment of § 61-b in New York, the stockholder's suit has become virtually extinct. The number of cases involving widely-held corporations instituted in New York County, for example, has fallen from an average of over fifty to two per year (*Hornstein, supra*, 47 Col. L. R., at 12). If it was the intention of the framers of the statute to abolish the stockholder's suit in publicly-held corporations, the objective has been marvelously accomplished.

Such legislative destruction of every remedy deprives the corporation as well as its stockholders of their property rights.* "Want of right and want of remedy are the same

* That the corporation's cause of action against its fiduciaries is property protected by the Constitution is too plain for argument. *Pritchard* v. *Norton*, 106 U. S. 124, at 132 (1882); *Ettor* v. *Tacoma*, 228 U. S. 148, at 156 (1913); *Forbes Pioneer Boat Line* v. *Everglades Drainage District*, 258 U. S. 338, at 340 (1922, Holmes, J.); *Graham* v. *Goodcell*, 282 U. S. 409, at 426 (1931).

The property rights of the stockholder are equally clear. True, the cause of action belongs primarily to the corporation and the stockholder is deemed only the "instigator" of the suit. However, the stockholder has an undivided equitable property right in the corporation's cause of action, *Pollitz* v. *Gould*, 202 N. Y. 11, at 15 (1911). He is "the equitable owner of an undivided fractional part of the entire assets of the company", *Flynn* v. *Brooklyn City R. Co.*, 158 N. Y. 493, at 504 (1899). The stockholder-plaintiff in a derivative suit thus is not a mere volunteer. He has "a real interest", *Ashwander* v. *Tennessee Valley Authority*, 297 U. S. 288, at 318 (1936). "It is only because the stockholder has an interest in the subject matter that he is allowed, when the directors will not pursue the guilty persons, or when they are themselves the alleged guilty persons, to bring the action himself"; *Ithaca Gas-Light Co.* v. *Treman*, 30 Hun (N. Y.) 212, at 213 (3rd Dept., 1883). Or, as it was recently put in *Goldstein* v. *Groesbeck*, 142 F. 2d 422, at 425 (C. C. A. 2, 1944); cert. den. 323 U. S. 737:

> "a shareholder's suit in essence is nothing more than a suit by a beneficiary of a fiduciary to enforce a right running to the fiduciary as such."

thing", *Edwards v. Kearzey*, 96 U. S. 595, at 600 (1878). Or, in the words of Mr. Justice Cardozo,

> "statutes which take away every remedy for past wrongs, as distinguished from statutes which merely change the remedy, are condemned as unconstitutional. The destruction of every remedy destroys the cause of action".
>
> *Jacobus v. Colgate*, 217 N. Y. 235, at 241-2 (1916).

For constitutional purposes it makes no difference that the remedy is destroyed by indirection rather than by outright repeal. "The State cannot escape its constitutional obligations by the simple device of denying jurisdiction in such cases to courts otherwise competent". *Angel v. Bullington*, 330 U. S. 183, at 188 (1947). To permit legal action in form, but to require prohibitive security as a condition precedent, is tantamount to barring it altogether. Thus in *Broderick v. Rosner*, 294 U. S. 629, at 640 (1935, Brandeis, J.), a state statute requiring that substituted process in an action be served upon many thousands of individuals was struck down because of the prohibitive expense entailed. In *Ex parte Young*, 209 U. S. 123, at 147 (1908), this Court held that "when the remedy is so onerous and impractical as to substantially give none at all, the law is invalid, although what is termed a remedy is in fact given". Broadly speaking, "penalties imposed on one party for the privilege of appeal to the courts deterring him from vindication of his rights, have been held invalid under the 14th Amendment": *Chicago & N. W. R. Co. v. Nye Schneider Fowler Co.*, 260 U. S. 35, at 47 (1922); *Missouri P. R. Co. v. Tucker*, 230 U. S. 340, at 348-351 (1913).

We submit that R.S. 1433-15 deprives petitioners here as well as the respondent corporation of their property.

5. Immunity to faithless corporation managements.

The effect of statutes such as § 61-b and R.S. 14-3-15 upon the economic system of this country is incalculable. Publicly-held corporations own the bulk of this country's industrial wealth; they own a large fraction of its total wealth; they control the major part of its industrial resources and its financial apparatus.* In this huge segment of our economy, ownership and control are sharply divorced. Ownership is dispersed among many millions of stockholders who have no effective voice in the management of their properties. Control rests with the corporate managements whose ownership interest in the properties entrusted to them is minute.** A large portion of our national wealth is thus managed by a small number of fiduciaries for a large number of absentee owners.

In a system such as this some effective means of judicial control over the fiduciaries occupying such pivotal positions is indispensable. Fiduciary rights without fiduciary accountability are unthinkable. A statute in effect absolv-

* "In 1909 the two hundred largest non-financial corporations held approximately a third of the assets of all such corporations. By 1930 over half of the assets were so owned. In 1933 the physical assets of the two hundred giants constituted about sixty percent of all those held by non-financial corporations, about half of the total industrial wealth, or about a fifth of the total national wealth." *Temporary National Economic Committee, Monograph 11, Bureaucracy and Trusteeship in Large Corporations* (1940), p. 4; *National Resources Committee, The Structure of the American Economy* (1939), I, 106-7.

** *Temporary National Economic Committee, Monograph 11, supra*, pp. 11, 12:

"* * * in approximately half of these companies the combined holdings of all members of the management and other important stockholders total only about five percent, while in more than fifteen cases did such total holdings constitute a majority of the potential votes.

"In half of the thirty-six Railroads examined the officers held not more than four-hundredths of one percent (the median) of the voting power. The corresponding percentages for public utilities and industrials are 0.17 and 1.38, respectively."

ing the fiduciaries from their legal responsibility would cut off the very roots of the economic structure of this nation.

R.S. 14:3:15 is such a statute. The stockholder's suit is the only avenue of redress not only for the stockholders, but for the corporations themselves against unfaithful managements in control of the corporations; and the threat of such suits is the only sanction restraining corporate fiduciaries otherwise free from any control or curb. The statute in effect destroys that remedy without substituting another. It stays the arm of justice from giving any protection to our publicly-held corporations and their stockholders. By thus extending immunity to corporate managements, it not only encourages them, but gives them complete license to disregard their duties and to deal with the properties entrusted to them as their uncontrolled self-interest may dictate. Such denial of right and remedy in the most important field of our economic life runs counter, we believe, to fundamental constitutional safeguards.

C

Denial of due process

It is elementary that the constitutional protection of property rights is not absolute. "Where the public interest is involved, preferment of that interest over the property interest of the individual, to the extent even of its destruction, is one of the distinguishing characteristics of every exercise of the police power which affects property"; *Miller* v. *Schoene*, 276 U. S. 272, at 279-280 (1928). But the police power, in turn, cannot be expanded to a degree that private property disappears; *Pennsylvania Coal Co.* v. *Mahon*, 260 U. S. 393, at 415 (1922, Holmes, J.). As stated by Mr. Justice Brandeis, "the police power is subject to the constitutional limitation that it may not be exerted arbitrarily or unreasonably"; *Nashville, C. & S. L. R. Co.* v. *Walters*, 294 U. S. 405, at 415 (1935). And

see *Daniel v. Family Security Life Ins. Co.*, U. S. 93 L. Ed. (adv.) 483, at 486 (1949).

We submit that R.S. 14:3-15 fails to meet this test of reasonableness.

1. *The purposes of the statute:*

In the absence of legislative hearings or findings, the objectives of § 61-b and R.S. 14:3-15 must be gathered from the gubernatorial messages accompanying them and from the Report of the New York State Chamber of Commerce which is the fountainhead of the new statutes. The messages and the Report describe the evils allegedly incident to stockholders' litigations. The existence of some of those abuses is not disputed; but their extent and the reasonable relation of the statutes to their cure is a different question.

(a) *Baseless Suits:*

The primary purpose of R.S. 14:3-15, as found by the Court below, was "to prevent losses to both domestic and foreign corporations and their stockholders by unjustified litigation" (R. 45). The assumed prevalence of unfounded stockholders' suits, which underlies this statement, is apparently predicated upon the statistics compiled in the Chamber Report. But those statistics are inconclusive and misleading; and the statute bears no reasonable relation to the pretended evil.

The Chamber Report surveys the incidence of stockholders' suits in New York and Kings County during the ten-year period from 1932 to 1942. Only 0.27% of all actions filed in New York County were stockholders' suits (1128 out of 421,417); and in Kings County the percentage was 0.16% (142 out of 86,840) (*Chamber Report*, p. 3). Only 573 out of these 1266 stockholders' actions involved publicly-held corporations (*Chamber Report*, p. 6). These figures would hardly support any thesis that minority stockholders' suits constitute an undue burden on the courts.

Out of the 573 actions involving publicly-held corporations, 10% resulted in actual corporate recoveries through judgment or court-approved settlements.* Whether this record of success is "good" or "bad" must depend upon its comparison with other types of litigation. It is a matter of common knowledge that only a small percentage of any type of actions reaches the stage of actual trial. In New York County, less than 5% of all suits, including commercial and tort actions of all kinds, reach trial (*McCook, J., Fourteen Years of Judicial Service*, 1933, p. 152). It should, therefore, be no cause for surprise that the stockholders' suits fared little better.

The Chamber Report completely fails to elucidate the grounds for which pre-trial discontinuances or dismissals have occurred in the derivative cases analyzed by it. This Court knows that stockholder litigation is "met with every obstacle and procedural delay that ingenuity of skilled counsel can devise"; *Dresdner* v. *Goldman Sachs T. Corp.*, 240 App. Div. 242, at 245 (2nd Dept., 1934). An examination of the results of those derivative actions in which issue was joined is therefore pertinent. Sixty-two percent of those cases resulted in corporate recoveries.** This, we submit, would seem to be no mean record of success.

But let it be assumed, contrary to actualities, that there exists a prevalence of unfounded actions in the derivative field. What relation does the statute bear to this evil?

* The *Chamber Report* (p. 6) lists recoveries in 13 cases; court-approved settlements in 33 cases, dismissals in 215 cases, private settlements in 60 cases and discontinuances in 155 cases, while 54 were pending and 43 showed no record disposition. Eliminating the last-mentioned 97 cases, it appears that 46 out of 476 cases, or 10%, resulted in corporate recoveries.

** *Your Investments* (American Investors Union), March, 1944, p. 27, finds

> "171 (stockholders') cases in which issues were joined. Out of this number there were 43 recoveries and 93 settlements, while only 65 suits were won by the defendants. In other words, 106 out of 171 suits were won by stockholders, or sixty-two percent of the cases involved."

Obviously, no stockholder will bring a clearly unfounded action unless he can hope for some kind of reward. A baseless derivative action will therefore be brought only in the hope that the plaintiff will be bought off for the nuisance value of his suit. The expectation of a "private settlement" is the only objective which can motivate a baseless derivative action.

Not the stockholder's suit as such, but the possibility of privately settling it is thus the root of the evil. Eliminate the private settlement, and you eliminate the "racket" of unfounded derivative actions. Had the Legislature really been concerned with the true abuse of stockholders' suits, the extortionate secret settlement, the remedy was painfully obvious: To bar secret settlements. This patent solution has been successfully adopted by Rule 23(c) of the Federal Rules.

R.S. 14:3-15 does not touch the private settlement. Instead of curing the evil, it kills the patient. For the statute bars not only the baseless, but equally the well-founded stockholder's suit. On a motion for security under the statute, "the merits of the action are not * * * before the Court" (*Shielcraut* v. *Moffett, supra*, 49 N. Y. S. 2d, at 70). No matter how meritorious the plaintiffs' case, no matter how clear the guilt of the defendants, the complaint can and will be silenced. The complete disregard of the statute for the merits of the action which it strikes down is one of the most obnoxious features distinguishing it from earlier similar enactments.* The statement that R.S. 14:3-15 is aimed only at "irresponsible strike suits" is thus without substance.

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* See, e.g., § 70 of the Patent Act, 35 U. S. C. § 70; § 9(e) of the Securities Exchange Act, 15 U. S. C. § 78i(e); § 282 of the Surrogate's Court Act of New York; and the following cases concerning them:

Fischer v. *Karl*, 6 F. R. D. 268, at 269 (D. C., E. D. N. Y., 1946);

Acker v. *Schulte*, 74 F. Supp. 683, at 688-690 (D. C., S. D. N. Y., 1947);

Re Pelcyger's Estate, 171 Misc. 1016 (1939);

Re Bray's Estate, 27 N. Y. S. 2d, 549 (1941).

(b) *Private Settlements of Well-Founded Actions:*

In further support of the statute, Governor Dewey's message stated:

> "Worse yet, many suits that were well based, have been brought not in the interest of the corporation or of its stockholders, but in order to obtain money for particular individuals who had no interest in the corporation or its stockholders. Secret settlements—really pay-offs for silence—have been the subject of common suspicion" (R. 46).

An amazing argument! "Many suits", it is conceded, "were well based". The guilty defendants bought silence by paying off the plaintiffs. Assuredly, such buy-offs are an evil calling for legislative action; for they prevent the return to the corporation of the moneys diverted by its unfaithful fiduciaries. A statute addressed to this abuse might be expected to make sure that justice will henceforth be done; that the "well based" action will be prosecuted to recovery for the corporation; and that it will not be thwarted by private settlement. But, strange to say, R.S. 14:3-15 does exactly the opposite. It makes sure that justice will *not* be done. Under the statute the stockholder's action, although "well based", is stifled at its very inception. The court is now forced to do what the wrongdoer heretofore achieved through the private pay-off: The diversion of the corporation's assets remains without redress and the wrongdoers enjoy perpetual immunity.

We submit that the evil of private settlements of "well-based" stockholders' suits is not "cured" by barring those suits altogether.

2. *Lack of Reasonableness of the Statute:*

It may be conceded that, by in effect abolishing the stockholder's action, the statute does away with the alleged abuses incident thereto. If no stockholder's action at all can be brought, none will be instituted that is unfounded, and none will be abused for an extortionate settlement.

But the cure is too radical to bear a reasonable relation to the evil. To illustrate: Much abuse has been inherent in the prosecution of personal injury actions. To deal with them would be a legitimate objective of the police power. A statute abolishing all relief for personal injury would radically eliminate the abuses. But we find it hard to believe that such drastic step would find constitutional sanction. R.S. 14:3-15 closely parallels such hypothetical statute.

Needless to say, no particular sanctity inheres in the stockholder's derivative action. If that mode of relief be thought inappropriate or dangerous, others may be prescribed by the Legislature in its place. But nothing of the kind was done; and we seriously question the right of a state, under the Constitution, to invite the public at large to invest its funds in corporate enterprises; to entrust the management of their property to the directors and executives of such corporations; and at the same time to deny the investor any effective right against the managerial diversion of his property.

To say that the evils envisaged by the Legislature could have been cured by less stringent means—such as the prohibition of private settlements or a preliminary judicial appraisal of the merits of the proposed stockholder litigation—raises more than a mere question of legislative wisdom. The existence of less drastic legislative cures has a direct bearing on the issue whether the absolute destruction of property rights of corporations and stockholders is "reasonably necessary for the accomplishment of the purpose (of the statute), and not unduly oppressive upon individuals", *Lawton* v. *Steele*, 152 U.S. 133, at 136-7. It is no answer that Legislatures are "laboratories for legislation" and that "early experiments are rarely perfect" (R. 55). Unless the due process clause of the Fourteenth Amendment, as applied to property rights, is to be deprived of all vitality, even an "experiment" must be subjected to the test of reasonableness.

In this case the evil of unfounded stockholders' suits and improper private settlements could have been dealt with by

limited legislative measures adapted to those very evils. The Legislature, instead, adopted a system which virtually abolished all effective legal protection of stockholders and corporations against their faithless fiduciaries and granted the latter complete and uncontrolled freedom from responsibility. If that be a legitimate objective of the state's police power, we know of no precedent so holding.

3. *Access to Court and Due Process:*

But it is not even necessary to debate the constitutional validity of R.S. 14-3-15 in the light of a generalized rule of reason limiting the state's exercise of its police power. For the special problem here involved, namely, the state's power to impede a litigant's access to the courts through the imposition of liability for counsel fees, has been the frequent subject of adjudication by this Court. The cases are listed in the footnote; their substance may be summarized as follows:

Common carriers, insurance companies and similar institutions had adopted the practice of delaying or refusing the payment of claims against them in the hope that the necessity of litigation might discourage the claimants from enforcing the full amount of their rights. In order to prevent such practices several states enacted statutes re-

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* *Life & Casualty Ins. Co.* v. *McCray*, 291 U. S. 566 (1934); *Dohany* v. *Rogers*, 281 U. S. 362 (1930); *Sioux County* v. *National Surety Co.*, 276 U. S. 238 (1928); *Chicago & N. W. R. Co.* v. *Nye Schneider Fowler Co.*, 260 U. S. 35 (1922); *Atchison T. & S. F. R. Co.* v. *Vosburg*, 238 U. S. 56 (1915); *Missouri Pac. R. Co.* v. *Larabee*, 234 U. S. 459 (1914); *Missouri K. & T. R. Co.* v. *Harris*, 234 U. S. 412 (1914); *Missouri K. & T. R. Co.* v. *Cade*, 233 U. S. 642 (1914); *Kansas City S. R. Co.* v. *Anderson*, 233 U. S. 325 (1914); *Chicago M. & S. P. R. Co.* v. *Polt*, 232 U. S. 165 (1914); *St. Louis I. M. & S. R. Co.* v. *Wynne*, 224 U. S. 354 (1912); *Seaboard Airline R. Co.* v. *Seegers*, 207 U. S. 73 (1907); *Farmers & M. Ins. Co.* v. *Dobney*, 189 U. S. 301 (1903); *Fidelity Mutual Life Ass'n* v. *Mettler*, 185 U. S. 308 (1902); *Atchison T. & S. F. R. Co.* v. *Matthews*, 174 U. S. 96 (1899); *Gulf, C. & S. F. R. Co.* v. *Ellis*, 165 U. S. 150 (1897).

quiring the companies to pay to successful claimants their reasonable attorneys' fees and a penalty. Counsel fees and penalties awarded under these statutes were, in most instances, moderate in amount, aggregating a few hundred dollars. In dealing with the constitutional validity of the statutes, this Court laid down this test: If they operated only as a stimulus to discourage delays by the companies in the payment of claims, the statutes were valid. But if they were such as to deter the companies from vindicating their rights, through the imposition of an excessive penalty for resorting to the courts, the statutes were invalid. In the leading case of *Chicago N. R. Co.* v. *Nye Schneider Fowler Co., supra*, 260 U. S. 35, this Court thus summarized the law:

> "In this scrutiny of the particular operation of a statute of this kind, we have sustained it in its application to one set of facts by the state court, and held it invalid when applied to another * * *" (p. 44).
>
> "This penalty or stimulus may be in the form of attorneys' fees. But it is also apparent from these cases that such penalties or fees must be moderate and reasonably sufficient to accomplish their legitimate object, and that the imposition of penalties or conditions that are plainly arbitrary and oppressive, and 'violate the rudiments of fair play' insisted on in the 14th Amendment, will be held to infringe it" (p. 44).
>
> "Penalties imposed on one party for the privilege of appeal to the courts deterring him from vindication of his rights, have been held invalid under the 14th Amendment. Missouri P. R. Co. v. Tucker, 230 U. S. 340. While the present case does not involve any such penalties as were there imposed, we think the principle applies to the facts of this case" (p. 47).

The same rule was laid down by Mr. Justice Cardozo in *Life & Casualty Ins. Co.* v. *McCray, supra*, 291 U. S. 566, at 574-5:

> "It is all 'a question of more or less'. Sexton v. Kessler & Co., 225 U. S. 90, 98. The price of error

may be so heavy as to erect an unfair barrier against the endeavor of an honest litigant to obtain the judgment of a court. In that event, the constitution intervenes and keeps the courtroom open. Ex parte Young, 209 U. S. 123; Wadley Southern R. Co. v. Georgia, 235 U. S. 651, 661, 662. On the other hand, the penalty may be no more than the fair price of the adventure. St. Louis, I. M. & S. R. Co. v. Williams, 251 U. S. 66. In that event, the litigant must pay for his experience, like others who have tried and lost."

The constitutional issue thus being reduced to "a question of more or less", we submit that the present case plainly is one of "more". Respondent has asked for a security of $125,000; and the Court below has recognized that the security will be "large" (R. 51). No comparable sum was involved in any of the cases decided by this Court. A statutory fine of $5,000 was struck down in *Ex parte Young, supra,* 209 U. S. 123, as foreclosing access to the court. Liquidated damages of $500 were held unconstitutional for the same reason in *Missouri P. R. Co. v. Tucker, supra,* 230 U. S. 340. The large liability which must be imposed on the present plaintiffs under the statute is so clearly and unmistakably prohibitive as to make further analysis of the authorities superfluous.

However, it is not only the *amount* of liability to be imposed on plaintiffs which places this case beyond the line drawn by this Court. In all previous cases reaching this Court the penalty was exacted only from a litigant who had lost and was thus adjudicated to be wrong. But these plaintiffs must raise a large security before they have even a chance to demonstrate the merits of their claim. These plaintiffs are thus not penalized for asserting an unjust claim. The statute is indifferent to the justice of their cause. Right or wrong, they cannot sue at all.

Worse than that. Even if plaintiffs were to give the security, they would have no assurance of retrieving it, even though they could prove their case to the hilt. For R. S. 1413-15 expressly authorizes the court to increase the security at any time before final judgment; if plaintiffs

are unable to give the additional security they will be dismissed and lose their original deposit. And they forfeit it not because of any lack of merit in their cause of action, but only because of the additional tax imposed upon them by the statute. R. S. 14:3-15 thus introduces this revolting innovation: Plaintiffs must pay their adversaries' counsel fees (out of their initial bond), not because their claim is unjust but because they are unable to back their claim with the unlimited further stakes envisaged by the statute.

We submit that "a judicial review beset by such deterrents does not satisfy the constitutional requirements"; *Oklahoma Operating Co. v. Love*, 252 U. S. 331, at 337 (1920, Brandeis, J.). Granted that "the Fourteenth Amendment does not prohibit the award of an attorney's fee, *moderate in amount*" (*Life & Casualty Ins. Co.* v. *McCray, supra*, 291 U. S., at 569, Cardozo, J., italics added); but the liability imposed on these plaintiffs will not be "moderate in amount", it will be prohibitive. Granted that "'the *unsuccessful* defendant must pay the adversary's costs" which "may include the fees of an attorney" (*Life & Casualty Ins. Co.* v. *McCray, supra*, italics added); but these plaintiffs are subjected to an unsupportable financial imposition regardless even of prospective merits; and they may have to forfeit their bond not only if they are ultimately "unsuccessful", but, despite impending success, if they are unable to meet additional security requirements. Such a statute, we believe, "violates the rudiments of fair play". It deprives plaintiffs of their cause of action. It deprives respondent itself of its cause of action. It exposes the corporate property to the grasp of an unfaithful management, without chance of redress. A statute such as this, we submit, offends the elements of due process required by the Constitution.

POINT II

Equal Protection of the Laws.

We contend that R. S. 14:3-15 denies to plaintiffs the equal protection of the laws, in violation of the Fourteenth Amendment to the Constitution.

1. R. S. 14:3-15 requires security from the small stockholder, but not from the large. A stockholder whose shares constitute less than 5% of the corporation's stock and have a value of less than $50,000 is subject to the statute. But one holding more than 5% or $50,000 worth of stock is exempt. It is not commonly thought in this country that bigness, as such, should be rewarded by special legislative privileges and that the small man, as such, should be subjected to special disabilities in public life. This view has, so far, also prevailed in the field of derivative suits; *Ashwander* v. *Tennessee Valley Authority*, 297 U. S. 288, at 318 (1936); *Everett* v. *Phillips*, 288 N. Y. 227, at 233 (1942).

2. Of course, it is elementary that equal protection does not forbid classification. But the classification, in order to be valid, "must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike"; *Frost* v. *Corporation Commission*, 278 U. S. 515, at 522 (1929). Or, as the rule was phrased recently in *Asbury Hospital* v. *Cass County*, 326 U. S. 207, at 214 (1945):

> "The legislature is free to make classifications in the application of a statute which are relevant to the legislative purpose. The ultimate test of validity is not whether the classes differ, but whether the differences between them are pertinent to the subject with respect to which the classification is made."

What relation then does the differentiation between large and small stockholders bear to the objectives of R. S. 14:3-15?

3. If R.S. 14:3-15 imposed equal liabilities on large and small stockholders, while requiring the small alone to give advance security, such differentiation might perhaps be justified by the presumably inferior financial responsibility of the small stockholder. Such, however, is not the statutory scheme. R.S. 14:3-15 discriminates not only in respect to *security*, but by imposing altogether different *liabilities* on large and small stockholders. The small stockholder must not only secure his adversaries' counsel fees; he must, if unsuccessful, pay them. The large stockholder is not only exempted from giving advance security; but he is, even if unsuccessful, under no liability for his adversaries' counsel fees (*supra*, p. 8). The hypothesized lack of financial means of the small stockholder certainly does not justify his being saddled with a greater burden of ultimate expense.

4. Nor does the discrimination against small stockholders bear any reasonable relation to the statute's purpose of eliminating baseless derivative suits. For the small stockholder, as defined in the statute, may have a palpably and undeniably meritorious case, and yet the statute bars him from relief by the requirement of security in a prohibitive amount. On the other hand, a large stockholder may bring a suit utterly lacking in merit, without hope of success and with an unworthy motive and malicious design; yet, no security may be exacted and, upon an adverse determination, he is not liable for more than the ordinary statutory costs applicable to all litigants. Unless the rights of a small claimant be conceived as presumably unfounded, and those of the large claimant as presumably meritorious, there is no basis for admitting one and excluding the other.

It has been said that the majority of stockholders' suits in publicly owned corporations have been brought by small shareholders. Small wonder, since the overwhelming majority of all shareholders in such corporations is small, and the few large ones are often identified with the management. Does it follow that the small stockholder's suit is presumptively unfounded?

It has further been suggested that self-interest will deter the large, but not the small stockholder from bringing a baseless derivative suit. For such a suit, it is argued, will involve the corporation in substantial expense; the corporate expenses would impair the value of a large block of stock more seriously than that of a small block; the large stockholder will, therefore, be more reluctant to involve the corporation in a reckless derivative litigation. The inference seems to be that the small stockholder, less restrained by self-interest than the large, may properly be singled out for legislative regulation.

However, the purported difference in the degree of self-restraint between large and small stockholders is completely lacking in substance. Whether a baseless derivative action be brought by a $10,000 stockholder in a $1,000,000 corporation, or by a $50,000 stockholder in a $5,000,000 corporation, the value of plaintiff's stock would in each case be reduced by precisely the same amount, i.e., one percent of the corporation's litigation expenses. The motives of self-interest, counseling against the institution of suit, would thus in both instances have precisely the same weight. And yet the plaintiff in the first case would, under the statute, have to give security, while the plaintiff in the second case would be exempt.

Even where the impact of corporate expenses would affect the large stockholder more extensively than the small one, the amounts involved are altogether too insignificant to justify legislative differentiation. Take the instant case. If this action were brought by a $50,000 stockholder, his proportionate share of respondent's pros-

pective litigation expenses would amount to $84.* This paltry sum, less than the ordinary taxable costs and disbursements, cannot possibly operate as a deterrent discouraging a "large" stockholder from instituting a baseless derivative action. The alleged differences of interested self-restraint thus bear no "fair and substantial relation" to the statute's discrimination between small and large stockholders.

Statistics, rather than speculation, would seem to furnish the most reliable test to determine the comparative merits of derivative suits brought by large and small stockholders, respectively. The only statistics available are those of the *Chamber Report* which can hardly be claimed to be partial to the small stockholder. Here is what the *Chamber Report* shows (p. 32):

In the case of *closely held corporations* (where the complaining stockholder presumably owns a comparatively large percentage of the outstanding stock), *five percent* of all derivative actions brought resulted in a corporate recovery. In the case of *publicly held corporations* (in which the complaining stockholder presumably owns a very small percentage of the outstanding stock), *eight percent* ** of all the derivative actions brought resulted in a corporate recovery (2% through judgments, 6% through court-approved settlements). This record, we submit, speaks for itself. It refutes any theory that a small stockholder's action may more readily be presumed to be baseless than that of a large stockholder.

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* The average value of respondent's common stock in 1947 was $25 per share (today's price: 23½). Thus a stockholder owning 2,000 common shares of respondent would meet the $50,000 test and be exempt from security. Since approximately 2,383,000 common shares of respondent are outstanding (*supra*, p. 10), such a stockholder would, in case of failure, have to bear 2,000/2,383,000, or 0.084% of respondent's litigation expenses. On the somewhat extravagant assumption that these expenses might amount to $100,000, the proportionate share thereof to be borne by a $50,000 stockholder-plaintiff would amount to $84.

** More accurately: 10% (*supra*, p. 19).

5. Another avowed purpose of the statute is the elimination of the secret private settlement of meritorious actions. But what relation does this objective bear to the differentiation between large and small stockholders? Large stockholders, and those allied with them, are equally as small ones apt to prefer their individual advantage to that of the corporation. Experience does not indicate that the standards of ethics and good moral conduct are higher among large than among small stockholders. Again the statistics of the *Chamber Report* shatter the rationale apparently underlying the statute's discrimination. Of all derivative actions brought on behalf of *closely held corporations,* fully *twenty-eight percent* were privately settled. Of all derivative actions brought on behalf of *publicly held corporations,* only *ten percent* were privately settled (*Chamber Report,* p. 32). Again, the record speaks for itself. If experience be a test at all, large stockholders are more amenable to the temptation of the private settlement than small ones.

6. Not only do we thus fail to find any "fair and substantial relation" between the objectives of R.S. 14:3-15 and its differentiation between large and small stockholders; but it may be added that discrimination based on wealth or poverty has traditionally been considered as particularly odious. This view was forcefully stated by Mr. Justice Brewer in *Gulf, C. & S. F. R. Co.* v. *Ellis,* 165 U. S., at 155 (1897):

> "But it is said that it is not within the scope of the 14th Amendment to withhold from states the power of classification, and that if the law deals alike with all of a certain class it is not obnoxious to the charge of a denial of equal protection. While, as a general proposition, this is undeniably true (citing cases), yet it is equally true that such classification cannot be made arbitrarily. The state may not say that all white men shall be subjected to the payment of the attorneys' fees of parties successfully suing them, and all black men not. It may not say that all men beyond a certain age

shall be alone thus subjected, or *all men possessed of a certain wealth*. These are distinctions which do not furnish any proper basis for the attempted classification." (Italics added.)

R.S. 14:3-15 does almost precisely what this Court said a state cannot do. And it does so in a particularly objectionable fashion. If wealth or poverty could furnish any basis at all for differentiation, the greater resources of the rich might justify their subjection to greater burdens. But R.S. 14:3-15 reverses logic, fairness and justice. The small stockholder, presumably lacking in means, is subjected to a huge imposition; the large stockholder, who might be better able to bear it, is left scot-free. The statute, we submit, bears all the earmarks of "invidious discrimination", *Queenside Hills Realty Co.* v. *Saxl*, 328 U. S. 80, at 85 (1946), which make it obnoxious to the Fourteenth Amendment, *Skinner* v. *Oklahoma ex rel. Williamson*, 316 U. S. 535, at 541 (1942).

We have recently been reminded that "equal protection of the laws is something more than an abstract right. It is a command which the state must respect, the benefits of which every person may demand. Not the least merit of our constitutional system is that its safeguards extend to all—the least deserving as well as the most virtuous." *Hill* v. *Texas*, 316 U. S. 400, at 406 (1942). We believe that a statute more flagrantly violating these precepts than R.S. 14:3-15 is hard to conceive.

Dated: New York, March 29, 1949.

Respectfully submitted,

JULIUS LEVY,
Attorney for William B. Weinberger, amicus curiae.

WILLIAM E. HAUDEK,
on the Brief.